

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9247

RIN 1545-BF23

Allocation and Apportionment of Expenses
Alternative Method for Determining Tax Book Value of Assets

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations providing an alternative method of valuing assets for purposes of apportioning expenses under the tax book value method of §1.861-9T. The alternative tax book value method, which is elective, allows taxpayers to determine, for purposes of apportioning expenses, the tax book value of all tangible property that is subject to a depreciation deduction under section 168 by using the straight line method, conventions, and recovery periods of the alternative depreciation system under section 168(g)(2). The alternative tax book value method is intended to minimize basis disparities between foreign and domestic assets of taxpayers that may arise when taxpayers use adjusted tax basis to value assets under the tax book value method of expense apportionment. These final regulations may affect taxpayers that are required to apportion expenses under section 861.

DATES: Effective Date: These regulations are effective January 30, 2006.

Applicability Dates: For dates of applicability, see §1.861-9(i)(4).

FOR FURTHER INFORMATION CONTACT: David Bergkuist at (202) 622-3850 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On September 14, 1988, the IRS published temporary regulations (TD 8228 (1988-2 CB 136) (53 FR 35467)) that address the allocation and apportionment of interest expense. On March 26, 2004, the IRS published a Treasury decision, TD 9120 (2004-1 CB 881) (69 FR 15673), which contained temporary regulations that provide for an alternative method of valuing assets for purposes of apportioning expenses under the tax book value method of §1.861-9T, and a notice of proposed rulemaking that cross-references the temporary regulations, 2004-1 CB 894 (69 FR 15753). A public hearing was held on July 19, 2004.

For purposes of allocating and apportioning expenses, a taxpayer may compute the value of its assets under either the tax book value method or the fair market value method. Sections 1.861-8T(c)(2) and 1.861-9T(g)(1)(ii). The temporary and proposed regulations issued in 2004 provided taxpayers with an alternative method of apportioning expenses under the tax book value method. This alternative tax book value method, which is elective, allows taxpayers to determine, for purposes of apportioning expenses, the tax book value of all tangible property that is subject to a depreciation deduction under section 168 by using the straight line method, conventions, and recovery periods of the alternative depreciation system under section 168(g)(2). The alternative method provided in the temporary and proposed regulations is intended to minimize basis disparities between foreign

and domestic assets of taxpayers that may arise when taxpayers use adjusted tax basis to value assets under the tax book value method of expense apportionment.

Taxpayers using the tax book value method, including those that have elected the alternative tax book value method, may elect to change to the fair market value method at any time. Rev. Proc. 2003-37 (2003-1 CB 950) (May 27, 2003).

Taxpayers that elect to use the fair market value method must continue to use that method unless expressly authorized by the Commissioner to change methods. See §1.861-8T(c)(2). See also Rev. Proc. 2005-28, 2005-21 IRB 1093 (May 23, 2005), regarding automatic consent procedure applicable for taxable years beginning on or after March 26, 2004, but before March 26, 2006, for which no return has previously been filed. Revocation of an election to use the alternative tax book value method, other than in conjunction with an election to use the fair market value method, for a taxable year prior to the sixth taxable year for which the election applies requires the consent of the Commissioner.

Explanation of Provisions and Summary of Comments

These final regulations adopt the rules of the temporary and proposed regulations. The alternative tax book value method, as set forth in §1.861-9(i), allows a taxpayer to elect to determine the tax book value of its tangible property that is subject to depreciation under section 168 of the Internal Revenue Code (Code) as though all such property had been depreciated using the alternative depreciation system under section 168(g) during the entire period in which the property has been in service. These final regulations prescribe the application of section 168(g)(2) solely for determining an asset's tax book value for purposes of

apportioning expenses (including the calculation of the alternative minimum tax foreign tax credit pursuant to section 59(a)) under the asset method described in §1.861-9T(g). Application of section 168(g)(2) pursuant to these final regulations does not otherwise affect the results under other provisions of the Code, including the amount of any deduction claimed under sections 167, 168, 169, 263(a), 617, or any other capital cost recovery provision.

As with the temporary and proposed regulations, the final regulations generally provide that, for a taxpayer that elects the alternative tax book value method, the tax book value of tangible property that is depreciated under section 168 of the Code is determined as though such property were subject to the alternative depreciation system under section 168(g) for the entire period that such property has been in service. Thus, if a taxpayer elects the alternative tax book value method effective for the 2005 taxable year, the tax book value of tangible property placed in service in 2005 is determined each year using the rules of section 168(g) that apply to property placed in service in 2005 and the tax book value of tangible property placed in service in 2006 is determined each year using the rules of section 168(g) that apply to property placed in service in 2006. However, in the case of tangible property placed in service in a taxable year prior to the first taxable year to which the election to use the alternative tax book value method applies, the tax book value of such property is determined using the alternative depreciation system rules that apply to property placed in service in the taxable year to which the election first applies. Thus, if a taxpayer elects the alternative tax book value method effective for the 2005 taxable year, the tax book value of tangible property placed in service in 2004

and prior years is determined each year using the rules of section 168(g) that apply to property placed in service in 2005. A special rule also applies in determining tax book value in cases where a taxpayer makes an election to use the alternative tax book value method after recently (within three years) revoking a prior election to use that method.

A public hearing was held and comments were received.

One commentator viewed the rule for property placed in service prior to the election to use the alternative tax book value method as unclear and suggested alternative phrasing to that in §1.861-9T(i)(1)(ii). As the commentator noted, any lack of clarity arises only if the rule of §1.861-9T(i)(1)(ii) is read in isolation, without reference to Example 1 in §1.861-9T(i)(1)(v). Because the Treasury Department and the IRS believe that the provision is clear when read in context and properly illustrated in §1.861-9T(i)(1)(v), and because the alternative phrasing suggested by the commentator would raise greater questions of clarity, the language from the temporary regulation is retained.

Commentators also requested that disparities in addition to depreciation, such as the treatment of intangible drilling costs and certain inventory adjustments, be addressed as part of the alternative tax book value method. The Treasury Department and the IRS are actively studying these and other disparities as well as what rules might be fashioned to address them. The final regulations therefore include a subsection that reserves as to certain other adjustments, pending the outcome of this review. The Treasury Department and the IRS welcome specific suggestions as to proper treatment of such adjustments.

One commentator requested that the IRS issue guidance granting automatic consent to change from the fair market value method to the tax book value method, including an election to determine tax book value using the alternative tax book method, in the context of a merger or acquisition, allowing the parties to the transaction to conform their methods. This comment is beyond the scope of the regulations, as it is part of a broader issue as to how to address inconsistent elections when companies merge or enter into similar transactions. Accordingly, the Treasury Department and the IRS have not considered it as part of finalizing the temporary and proposed regulations.

One commentator suggested that taxpayers be able to elect the use of the alternative tax book value method for all open years. Adoption of this suggestion would raise significant fairness and administrative concerns. Accordingly, the suggestion was not adopted, and the effective date set forth in the temporary regulations is retained.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were

submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these regulations is David Bergkuist, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph. 1. The authority for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.861-9 is amended as follows:

1. Revise paragraphs (h)(6) and (j).
2. Add paragraph (i).

The revision and addition read as follows:

§1.861-9 Allocation and apportionment of interest expense.

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(h)(6) [Reserved]. For further guidance, see §1.861-9T (h)(6).

(i) Alternative tax book value method--(1) Alternative value for certain tangible property. A taxpayer may elect to determine the tax book value of its tangible property that is depreciated under section 168 (section 168 property) using

the rules provided in this paragraph (i)(1) (the alternative tax book value method).

The alternative tax book value method applies solely for purposes of apportioning expenses (including the calculation of the alternative minimum tax foreign tax credit pursuant to section 59(a)) under the asset method described in paragraph (g) of this section.

(i) The tax book value of section 168 property placed in service during or after the first taxable year to which the election to use the alternative tax book value method applies shall be determined as though such property were subject to the alternative depreciation system set forth in section 168(g) (or a successor provision) for the entire period that such property has been in service.

(ii) In the case of section 168 property placed in service prior to the first taxable year to which the election to use the alternative tax book value method applies, the tax book value of such property shall be determined under the depreciation method, convention, and recovery period provided for under section 168(g) for the first taxable year to which the election applies.

(iii) If a taxpayer revokes an election to use the alternative tax book value method (the prior election) and later makes another election to use the alternative tax book value method (the subsequent election) that is effective for a taxable year that begins within 3 years of the end of the last taxable year to which the prior election applied, the taxpayer shall determine the tax book value of its section 168 property as though the prior election has remained in effect.

(iv) The tax book value of section 168 property shall be determined without regard to the election to expense certain depreciable assets under section 179.

(v) Examples. The provisions of this paragraph (i)(1) are illustrated in the following examples:

Example 1. In 2000, a taxpayer purchases and places in service section 168 property used solely in the United States. In 2005, the taxpayer elects to use the alternative tax book value method, effective for the current taxable year. For purposes of determining the tax book value of its section 168 property, the taxpayer's depreciation deduction is determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) as in effect in 2005 to the taxpayer's original cost basis in such property. In 2006, the taxpayer acquires and places in service in the United States new section 168 property. The tax book value of this section 168 property is determined under the rules of section 168(g)(2) applicable to property placed in service in 2006.

Example 2. Assume the same facts as in Example 1, except that the taxpayer revokes the alternative tax book value method election effective for taxable year 2010. Additionally, in 2011, the taxpayer acquires new section 168 property and places it in service in the United States. If the taxpayer elects to use the alternative tax book value method effective for taxable year 2012, the taxpayer must determine the tax book value of its section 168 property as though the prior election still applied. Thus, the tax book value of property placed in service prior to 2005 would be determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) applicable to property placed in service in 2005. The tax book value of section 168 property placed in service during any taxable year after 2004 would be determined by applying the method, convention, and recovery period rules of the alternative depreciation system under section 168(g)(2) applicable to property placed in service in such taxable year.

(2) Timing and scope of election. (i) Except as provided in this paragraph (i)(2), a taxpayer may elect to use the alternative tax book value method with respect to any taxable year beginning on or after March 26, 2004. However, pursuant to §1.861-8T(c)(2), a taxpayer that has elected the fair market value method must obtain the consent of the Commissioner prior to electing the alternative tax book value method. Any election made pursuant to this paragraph (i)(2) shall apply to all members of an affiliated group of corporations as defined in §§1.861-11(d) and 1.861-11T(d). Any election made pursuant to this paragraph (i)(2) shall apply to all subsequent taxable years of the taxpayer unless revoked by the taxpayer.

Revocation of such an election, other than in conjunction with an election to use the fair market value method, for a taxable year prior to the sixth taxable year for which the election applies requires the consent of the Commissioner.

(ii) Example. The provisions of this paragraph (i)(2) are illustrated in the following example:

Example. Corporation X, a calendar year taxpayer, elects on its original, timely filed tax return for the taxable year ending December 31, 2007, to use the alternative tax book value method for its 2007 year. The alternative tax book value method applies to Corporation X's 2007 year and all subsequent taxable years. Corporation X may not, without the consent of the Commissioner, revoke its election and determine tax book value using a method other than the alternative tax book value method with respect to any taxable year beginning before January 1, 2012. However, Corporation X may automatically elect to change from the alternative tax book value method to the fair market value method for any open year.

(3) Certain other adjustments. [Reserved.]

(4) Effective date. This paragraph (i) applies to taxable years beginning on or after March 26, 2004.

(j) [Reserved]. For further guidance, see §1.861-9T(j).

Par. 3. Section 1.861-9T is amended as follows:

1. Revise the second sentence in paragraph (g)(1)(ii) introductory text.
2. Revise paragraph (i).

The revisions read as follows:

§1.861-9T Allocation and apportionment of interest expense (temporary).

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(g) * * *

(1) * * *

(ii) * * * For rules concerning the application of an alternative method of valuing assets for purposes of the tax book value method, see §1.861-9(i). * * *

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(i) [Reserved]. For further guidance, see §1.861-9(i).

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/s/ Mark E. Matthews

Deputy Commissioner for Services and Enforcement

Approved: January 20, 2006

/s/ Eric Solomon

Acting Deputy Assistant Secretary of the Treasury.